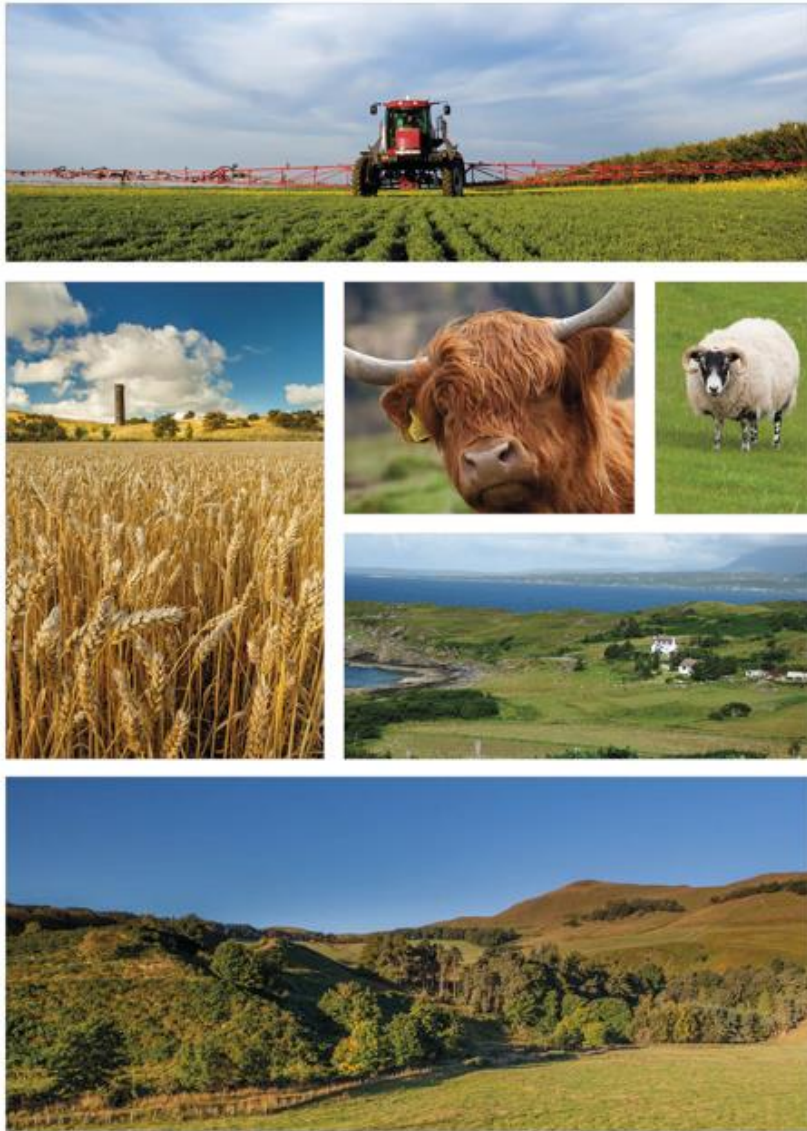


New Entrants to Farming Programme

Succession in Sheep Stock Clubs

Points to consider



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Succession

Succession in situations where you become a tenant of a croft business and a member of a sheep stock Club simultaneously can be confusing. This is because you are succeeding to two different businesses, with different business structures, and often enterprises, at the same time.

This guide only refers to the most direct succession route in a Sheep Stock situation. This is where the croft tenancy and grazing share, which includes membership of a Sheep Stock Club, are assigned directly from one person to another (this is often a family member).

What is a Sheep Stock Club?

Sheep Stock Clubs have a long heritage in the Highlands and Islands, with many established after the First World War when a number of crofting townships were first formed. Sheep Stock Clubs can broadly be defined as sheep flocks held in common ownership on a defined area of land, and farmed for collective benefit. Whilst most are primarily concerned with sheep farming, some do have a limited number of cattle.

The sheep are farmed collectively on the common grazing and the returns from sales, after the deduction of costs and reserves, are split equally amongst the shareholders in the club.

Historically, rights in a Sheep Stock Club were generally linked to the crofter's share of the common grazings in a crofting township. When the Sheep Stock Club was set up, each croft was allocated a share in the flock. Accordingly, each crofter's interest in the Sheep Stock Club was dependent on, and indivisible from, his/her share in the common grazing. In essence, the flock was seen as an indivisible whole with no shareholder permitted to keep private sheep on the common grazings.

Given that permission to run a Sheep Stock Club on a common grazings was done under the auspices of the crofting regulations pertaining at the time, many of the rights and obligations of the Sheep Stock Clubs are specified under the individual common grazings regulations. In other words, general guidance often existed concerning the sheep stock club itself but less so with respect to operational procedures and individual members' rights and obligations. These tended to be agreed at a local level and many have changed considerably over time.

Points to consider in succession planning involving a Sheep Stock Club

1. What will be your identity, after succession?

Once the succession is completed, you will have three separate crofting identities, described below. Although these often overlap, it is important to consider them separately, and understand your rights and responsibilities.

a) Croft tenant

You will be the tenant of your in-bye croft and you will have full control over this land. Many crofters operate as sole traders, but you should seek advice on the best business structure for your crofting business. You will have the right to use the common grazing for your own stock but this land is managed in collaboration with your fellow crofters, and the management is controlled by the elected grazings committee.

b) Common Grazing shareholder

You will have a share in the common grazing. Typically, this will only allow you to graze cattle, as only the sheep belonging to the Sheep Stock Club are permitted to graze the common. You should refer to your common grazings regulations. You should also check whether the common grazing is under any management schemes i.e. forestry or agri-environment.

You should consider how the crofter you are succeeding used the common grazings. You should also check if they have a committee position.

It is good practice to let the grazings committee know about your succession plans before you start the work of croft registration and assignments.

You should also let them know if you intend to use the common grazings in similar way, or what changes you propose.

If the person assigning the croft had a committee role, you may wish to offer to continue that role, or notify the committee that such a role will need to be filled.

c) Member of the Sheep Stock Club

Depending on the legal structure that the Sheep Stock operates under, the succession may involve slightly different procedures.

Good practice would be to explain your succession plans to the clerk (or similar role) in the Sheep Stock Club. This would allow them to advise you on what procedures are needed to be done when the assignment is approved by the Crofting Commission.

Again, it is even more crucial that you undertake an audit of all the activities/roles that the previous crofter undertook in the Sheep Stock Club. These can fall under various guises, from day to day sheep management, general management decisions, financial management, managing schemes such as agri-environment and associated paperwork.

It is crucial that you start discussions with your fellow Sheep Stock Club members early, so there are no unexpected gaps in the running of the Club after your succession.

2. What legal structure does the Sheep Stock Club have? What are the implications for you as a member?

The following three legal structures are the most common. However, other organisational models, such as Companies Limited by Guarantee, Community Interest Companies, Limited Liability Partnerships, and various co-operative models are possible; you can find more information about them on the FAS website.

Unincorporated Association

Many Sheep Stock Clubs operate as unincorporated groups, either with or without a written constitution. Constitutions, where they exist, tend to follow a standard format with respect to membership and governance. These tend to be found in smaller townships where the principals are all known to each other and operate largely on custom and practice. The Club holds the sheep in common ownership for the members, and the members decide how the flock is managed. The management of the flock on the common grazing can be done by all or some of the members, either on a paid or voluntary basis. Some Sheep Stock Clubs employ dedicated shepherding staff and others use outside contractors.

As an unincorporated group, all members are jointly and severally liable for all debts and liabilities of the Club. The decision as to whether to incorporate tends to depend on the level of risk and liability to which the group is exposed. Some smaller groups prefer the relative freedom and low cost operation of the unincorporated model. Some seek to offset some of the risk by taking out employers and public liability insurance.

Unincorporated groups are required to be registered with HMRC with respect to tax and VAT, where these are applicable. Some groups, however, seek to minimise the tax liability of the group by returning dividends to the members thereby reducing the tax position of the group.

Most Sheep Stock Clubs are set up on the basis that certain defined crofts in the township are the sole members i.e. they are automatically or historically members and no other outside party may become a member of the club. In these circumstances, the membership is restricted and entry to the club only possible by assignation of a croft tenancy.

In many unincorporated Sheep Stock Clubs, it is not clear as to the exact legal position with respect to sale or transfer of an existing member's shareholding. This often takes place by private arrangement between members but it would be recommended that legal advice be taken to establish and confirm the legal ownership position before entering into any form of sale/purchase contract.

Companies Limited by Shares

As above, a Sheep Stock Club may decide to incorporate as a Company Limited by Shares registered with Companies House to minimise the risk and exposure to members.

The primary purpose of a limited company is to derive dividend and/or capital value for the shareholders. In a limited company, the member's agreement is often referred to as a shareholder's agreement. The primary advantage of the limited company is that the shareholder's liability is limited to the value of their shareholding. In other words, their liability is limited to the value of their investment in the company.

Where allowed in the Memorandum and Articles of Association, the advantage of the limited company is that shares can be traded to allow new entrants to buy a share in the company and exiting members to sell.

It could, however, allow any individual shareholder to acquire additional shares, and consequently the additional voting rights. On this basis, one or more individuals could assume a greater controlling interest in the company which, on one hand might provide a stimulus to growth and activity, but on the other, might not be seen as fair and equitable across the wider crofting community.

Consideration should be given to how the member's share in the common grazing and his/her share in the Sheep Stock Club could be accommodated under the current crofting legislation and local common grazing regulations.

Similarly, the standard Memorandum and Articles of Association should be reviewed with respect to how the shareholders want the company to be structured and run. Developing a company based Sheep Stock Club model would require specialist legal and crofting advice to make sure that, in addition to providing additional benefit and protection to members, it met all company and crofting legislation.

Registered Co-operative

A co-operative register by the Financial Conduct Authority carries the same level of limited liability as a limited company. The primary difference is that the co-operative exists for member benefit and not for dividend on profits and/or capital gain.

Co-operatives are generally structured around member economic participation - the greater use the member makes of the co-operative, the greater return they will receive in terms of trading bonuses and on dissolution. Shares in a co-operative remain at par and, dependent on the rules, may or may not be withdrawable or transferrable. In other words, a member may join the co-operative and benefit from its trading activities, but on leaving is only entitled to the value of his/her shares (if allowed for in the rules), and not an apportionment of the capital value of the business.

In order to address this issue, marketing co-operatives may set up what are termed “qualification loans”. These are loans in the member’s name which are generally repayable within five years of leaving. The individual qualification loans may be built from a pro rata allocation of profits from the co-operative’s trading activities.

The advantage of this is that the member gets some degree of financial return for their participation in the co-operative. The disadvantage is that the member is eligible for tax when the money, which remains in the co-operative, is allocated to his/her account.

Another option is to have shadow accounts set up within the co-operative which defines an allocation from reserves to which a member is entitled to on leaving. The advantage of this is that tax on allocations received only becomes due on exit. However, the monies only become due to the member on exit and therefore are not considered in the interim as loans.

The co-operative model suits the situation where the Sheep Stock Club exists for fair and equitable return to members. As allowed for in the rules of the co-operative, and approved by the Board of Directors, membership of the co-operative may be transferred at terms and conditions agreed between the new and retiring member.

Nevertheless, it is important to note that membership of the co-operative does not entitle the shareholder to an equal share of the capital value of the co-operative on exit. In this respect, the co-operative structure best fits a situation where there are a number of members of similar size and ambition and there is a notion of long term operation. It does not lend itself particularly well to exit of existing members and entry of new ones.

3. What role do you envisage for yourself in the Sheep Stock Club?

It is important that you consider what role you want for yourself in the Sheep Stock Club.

What skills do you have? These can include:

- Shepherding
- Cattle management
- Maintenance skills i.e. fencing, stone dykes or fanks
- Livestock records
- Administration for subsidies
- Ecological skills for agri-environment work
- Financial administration work
- Committee work
- IT Skills
- Social media
- Catering for fank days and committee meetings
- Skills for diversification

It is also important to consider what time you have to give to the Sheep Stock Club. Review your other commitments with the crofting business you are taking on, whether employment voluntary or family commitments.

This is all useful preparation before speaking to your future fellow shareholders in the Sheep Stock Club so you can co-operatively decide what role you can play as a new member.

New Members a Catalyst for Review?

Bringing in new Sheep Stock Club members can be a good time to review the general running of the Club and see what effect the loss of old members and the addition of new members will bring.

a) Review the Performance of the Sheep Stock Club

It might be a good time to look at how the sheep flock are performing in terms of lambing percentage, weaning percentage, sale weights and prices. This ideally should be benchmarked against other sheep stock clubs or similar flocks.

b) Review the Condition of any sheep stock club buildings or equipment?

It is good to consider the condition of your equipment and what needs repaired and replaced in the next 5 – 10 years. Sheep Stock Clubs are eligible for CAGS under the auspices for the common grazing. At present they can draw down an 80% grant of up to £125,000 every two years. It is good practice to have an agreed plan for future improvements.

c) Review the financial performance of the Sheep Stock Club

It is good for members to periodically review the financial performance of the sheep stock club business. It is crucial that new members understand what dividend if any is likely and also what liabilities they may be subject to. It is important the club has reserves to help with delays in subsidy payments and to mitigate poor livestock sales.

d) Members' Agreement

This can be a good time to look at updating or drawing up a members' agreement.

In writing a members' agreement it is important for sheep stock clubs to consider what they want to achieve that provides maximum benefit to the membership with minimal risk. It is important to consult widely within and outwith the membership to ensure that all pertinent factors that affect the members' agreement are taken into account. It is important to engage professional support to ensure the final document is fit for purpose and legally founded before presenting it to the membership for approval.

Members' agreements can vary widely depending on the nature and operation of the organisation. However, with most Sheep Stock Clubs the basic model and method of operation are fairly similar with minor local variations.

Whilst the members' agreement defines the contractual relationship between the member and the Sheep Stock Club, the operating rules define the day-to-day operations of the organisation. It is important that the committee or Board of Directors can manage operations without need to continually refer to the wider membership.

Members' agreement might contain some or all of the following -

- **The name of the party to the members' agreement** – it is important to define if the member is an individual, partnership, limited company that has rights in the common grazing (and therefore a share in the Sheep Stock Club), or otherwise, as approved by the Grazings Committee and/or the Crofting Commission.
- **Definitions & Interpretations** – to negate any lack of clarity or ambiguity, it is necessary to list all relevant legislation, rules and regulations, areas, livestock, committed time or financial contribution, managing arrangements, operating procedures, and any other term(s) referred to within the agreement.
- **Common Grazing Regulations** – where these are specific to, or under general application, the common grazings regulations supersede the rules of the sheep stock club and all members should be aware of their rights and obligations under the regulations applying. It is important to consider how the souming is allocated by the grazings committee and the limits on the size of the flock.
- **The Role and Powers of the Committee / Board of Directors** - the composition and powers of the Committee/ Board of Directors should be clearly stated with respect to the governance and operation of the Sheep Stock Club. Such matters may include the selection and procurement of certain types of sheep breeds, tups, hefting, drawing, lambing, selection of replacements and general improvements amongst others. It is important to define the role of the Committee / Board of Directors with respect to engaging outside contractors, setting internal payment rates and allocation of duties.
- **Member Commitment** – members should be fully aware of their obligations and responsibilities with respect to the Sheep Stock Club. Such duties may include an allocation of time, money or use of other facilities and/or resources to support sheep stock operations and activities.
- **Livestock Management** – all members of the Sheep Stock Club have a duty of care to the livestock in their possession. Gathering, clipping dosing, handling etc. must be undertaken with due regard to the animals' wellbeing. All members of the Sheep Stock Club carry a duty of care in this respect.
- **Livestock Marketing** - the member should be made aware of the Sheep Stock Club's policy with regard to routes to market and local sales.
- **Allocation of Surplus** – the member shall be advised of policy with respect to allocations of surplus.

- **Duration and Termination of Agreement** – the length of the agreement and how it can be terminated by both parties.
- **Assignment & Death** – the rights and obligations of both parties on assignment or death.
- **Bankruptcy & Liquidation** – to define what happens in event of a personal bankruptcy or business going into liquidation.
- **Breach** – the actions to be taken in the event of a breach by either party to the agreement and the remedies available.
- **Arbitration** – the actions to be taken when no resolution to a dispute can be reached.
- **Modification of Agreement** – the mechanism by which the agreement can be altered.
- **Loans and Other Charges** – provision for the member to make.
- **Force Majeure** – defined as unavoidable loss.

In terms of day to day sheep flock operations, the annual calendar of should be considered in light of individual responsibilities.

For example, a typical sheep calendar for the Highlands and Islands might be –

Month	Task
January	Complete gather, take tups back in, dose ewes, stock tups back to grazings, cast tups to sale and mineral blocks out.
February	Mineral blocks out, machinery maintenance.
March	Mineral blocks out and lean ewes fed.
April	Mineral blocks out, hoggs returned dipped, dosed and put back to their hirsels, lambing duties.
May	Lambing duties.
June	Marking lambs and ewes dosed.
July	Clipping.
August	Ewes dosed, ewe lambs selected and tagged, store lambs tagged and sold.
September	Cast ewes sold, stock ewes dipped and dosed.
October	Ewe lambs dipped, dosed and sent to wintering, tups purchased.
November	Tups out.
December	Mineral blocks out.

It is important to make the member aware of what his/her contribution and commitment to the Sheep Stock Club will be with respect to the overall programme and how the Committee/Board of Directors wish to resource and carry out the various operations.

It is also important to have the member's agreement signed and witnessed by both two members of the Committee / Board of Directors and the individual member.

The members' agreement for each Sheep Stock Club will be different although there may be many points of commonality. Professional assistance should be sought to ensure that any agreement drawn up is fair, equitable and transparent, and that both parties have a clear understanding of their legal rights and obligations.

Case Study: Kingsburgh Sheep Stock Club

In the last decade Kingsburgh Sheep Stock Club on the Isle of Skye has seen a significant majority of its members succeed the previous generation.

Yvonne White, Grazing Clerk explains "This has been, in general, a positive experience and we are happy that we can continue the tradition that we all grew up with. We all remember childhood times at the fanks.

However, it has taken a lot of work and discussion to capture all the knowledge that long-standing members had. We are now moving forward to embrace the challenges of the current climate, such as Brexit and difficulty in getting sufficient gatherers. We have started an Integrated Land Management Plan (ILMP) to give us further advice on land management and see if there are new opportunities for income."

Sources of Support

If you need additional advice, please contact:

- FAS helpline - 0300 323 0161 or email advice@fas.scot
- Consider undertaking an Integrated Land Management Plan (ILMP) <https://www.fas.scot/integrated-land-management-plans-ilmps/>
- For advice on groups and co-operative structures, please contact: SAOS, <http://www.saos.coop>